# Economic Development

**PRELIMINARY DRAFT FOR DISCUSSION ONLY**

*This preliminary draft discussion paper is a work product developed by the consulting team for review and discussion by the Blue Ribbon Commission on Transportation. The contents are intended to provide the Commission members with factual background information and a balanced set of policy alternatives, including the pros and cons of these alternatives. This paper is one of a series and should be reviewed in the context of the entire series that, when taken together, presents a comprehensive overview of the state's transportation system.*

*This discussion paper has been prepared primarily for Blue Ribbon Commission members new to these issues who wish to engage in a fundamental debate and for a more general audience of interested citizens who may wish to comment on the Commission's deliberations. This paper is intended to be provocative and to stimulate discussion of issues and options in this state. It questions the current ways of doing business, not for the sake of finding fault, but to allow consideration of other potential ways of thinking about transportation issues that might be appropriate in the future.*

## PROBLEM STATEMENT

Washington State as a whole has experienced robust economic growth in recent decades, but not all regions of the state have shared equally in that prosperity. While areas like Puget Sound enjoy vibrant economies with rapid growth in personal incomes and low unemployment, the economies of some areas in Washington remain sluggish. In fact, in many rural counties across the state, unemployment rates have hovered in the double digits for years.[1]

Some people believe that one effective way to promote economic growth in lagging areas is to invest in the transportation infrastructure of these regions. These advocates believe that improving an area's transportation links to other regions can make that area more attractive as a center of economic activity, thus spurring growth and improving economic equity across the state. The problem, as they see it, is that when we consider how transportation investments are selected, current practices do a poor job of accounting for "economic development" benefits. Thus, economically lagging regions are shortchanged when it comes to allocating transportation investments.

[1] Washington State Department of Employment Security, *1998 Washington State Labor Market and Economic Report* and *Washington Labor Market February/March 1999.*

## PROPOSED SOLUTION

This paper discusses the option of including an economic development criterion as part of an investment selection and priority-ranking evaluation process. Such a consideration would boost the ranking of transportation investments that would potentially benefit the economies of lagging areas.

## BACKGROUND AND RATIONALE

According to generally accepted practices in transportation planning, the way to make the best transportation investments is to conduct a rigorous assessment of the benefits and costs of every major project in a given area. Based on that analysis, decisionmakers should fund only those projects (or the combination of projects) that generate the greatest net benefits. Most decisions about transportation investments in Washington State include some consideration of benefits and costs, as well as effects not easily expressed in dollar terms, such as environmental effects. However, the analysis of benefits and costs is rarely done with a high level of analytic rigor, and the methods for selecting projects vary from jurisdiction to jurisdiction. (See Blue Ribbon Commission policy paper's on "Transportation 'Needs' Exceed Available Funding.")

The state has an obvious incentive for improving the project selection process. Given the magnitude and importance of transportation investments, a failure to fund the best projects across the state could easily cost residents billions of dollars in lost benefits.

### Overview

One important issue in moving towards best practices in investment evaluation is the treatment of the benefits associated with economic development. Many believe that investments in transportation infrastructure can generate far-reaching economic development benefits. Some believe, further, that benefit-cost analyses do a poor job of capturing the true value of these benefits. In response to this perceived shortcoming, some advocate adding an explicit economic development criterion to the project selection process.

In contrast, those who oppose adding an economic development criterion to project selection argue that in our mature transportation system, any given investment will have only very small effects on economic performance. They point out, further, that benefit-cost analyses are designed to capture precisely these effects. They argue that, while it is important to account for *all* of a project's anticipated effects – counting *all* benefits and *all* costs – the best way to do so is through the rigorous framework of a well-executed benefit-cost analysis.

Traditional benefit-cost analyses sometimes fail to capture all of the benefits associated with transportation investments. For instance, if a project calls for widening a road between mile markers A and B, then a typical benefit-cost analysis might count all of the benefits expected to accrue to users between those mile markers. However, it might not consider systemic benefits generated throughout the transportation network.

Another widely acknowledged shortcoming of the benefit-cost framework is that the analysis has difficulty considering non-linear benefits. For example, if a project is expected to make travel times shorter and more predictable, then analysts will count the value of the expected time savings. What analysts generally do *not* examine is how the new transportation environment provides users with opportunities to restructure the way they do things. For example, improved mobility might allow a firm to consolidate warehouses to achieve economies of scale and reduce operating costs. Simultaneously, shorter driving times might allow a family to shift to owning

only one car instead of two, saving them money on overhead items like insurance and parking. If some firms or households take advantage of these opportunities, as opposed to simply enjoying the time savings, then a calculation of benefits based on projected time saving will underestimate total benefits, and the benefit-cost calculation will miss important information.

Opponents of an economic development criterion note the shortcomings of traditional benefit-cost analysis, but they counter that developing better estimates of changes in travel demand and travel costs throughout the system is the answer, rather than adding a new criterion to the selection process. If economic development impacts influence decisionmaking outside the framework of benefit-cost analysis, they argue, it compromises the selection process. They argue that, ultimately, if an economic development criterion is included in the decisionmaking process, the investment prioritization process can become overly politicized, and the state may fund a list of investments that promises fewer total benefits.

## Arguments in Support of an Economic Development Criterion

Arguments in favor of using economic development considerations in setting investment priorities include:

- **Transportation investments *can* lead to economic growth.** Advocates who call for including economic development considerations correctly point out that, when the right conditions are present, the addition of transportation investments can lead to economic growth.

  Adequate transportation facilities are a necessary but not sufficient condition for economic growth. If an area has all of the other necessary components – such as a qualified but underused labor force and access to materials, equipment, and markets – but transportation links are missing, then building those links can allow more complete utilization of resources, and thus lead to economic growth.[2]

  On a local level, proponents of a given project can always point to firms that stand to gain from the investment. If these firms flourish as a result of the investment, they argue, then economic performance (at least in that specific area) should improve.

- **Road construction projects themselves generate employment and income.** In areas of the state where unemployment is high, the employment and income that road construction projects generate can provide an economic boost. This effect is only short-term, but in instances where the direct and indirect labor would have gone unused if the investment did not occur, it represents a real economic benefit.[3]

- **Favoring transportation investments in economically lagging areas helps reduce regional inequities.** One of the goals of state policy is to encourage the economic development of distressed areas. Any transportation investment that provides real economic benefits to distressed areas helps to further that goal.

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[2] Transportation Research Board, *Assessing the Economic Impact of Transportation Projects: How to Choose the Appropriate Technique for Your Project*, October 1997.

[3] United States Department of Transportation Federal Highway Administration, *Least-Cost Planning: Principles, Applications and Issues*, July 1995.

## Arguments Against an Economic Development Criterion

The arguments that opponents offer against including an economic development criterion in setting investment priorities include the following:

- **In a mature transportation system, additional investments have little effect on economic performance.** Proponents of transportation investments often argue that such investments will have a large effect on regional competitiveness and substantially improve the region's economic performance. Economic analysis, however, has found that this is not the case. A series of the most exhaustive studies to date found that, in the mature transportation system of the United States, investments in public infrastructure have only very small effects on economic growth.[4]

  Intuitively, everyone knows that the ability to move people and goods is crucial to economic activity. What the studies show is that, given the extensive system we already have, adding more capacity in one place or reducing capacity elsewhere does not substantially change a region's overall economic performance. Investments will always benefit some people and firms in a given area, and thus rearrange the playing field, but the economic benefits to the region as a whole are small.

  In an article that specifically addresses the economic development of rural areas, David Forkenbrock and Norman Foster of the University of Iowa conclude:

  > Speculative highway investments intended to provide unneeded capacity in places where businesses may possibly choose to locate, without any certainty that this will actually happen, are likely to work counter to economic development within the state. At this mature stage of development of the rural highway system, proper maintenance and relatively minor improvements are likely to be a more cost-effective strategy contributing to an area's economic development potential.[5]

- **Adjusting how investments are selected by including an economic development criterion (at least from a state perspective) means purposely choosing investments with fewer net benefits**. If calculations of net benefits truly are the way to identify the best investments, then using any other criterion to influence the rankings means purposely rearranging the rankings to make investments that will generate fewer net benefits.

  Many transportation planning guidebooks call for prioritizing investments according to a rigorous examination of all social costs and all social benefits for every major transportation investment.[6] Given this framework, if decisionmakers want to identify the best investments, they should rank each investment according to the net benefits it produces and fund projects

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[4] Transportation Research Board, *Macroeconomic Analysis of the Linkages Between Transportation Investments and Economic Performance*, 1997.

[5] David Forkenbrock and Norman Foster: *Highways and Business Location Decisions*, Economic Development Quarterly, Volume 10, No.3 (August 1996).

Transportation Research Board, National Cooperative Highway Research Program: *NCHRP Synthesis 243 – Methods for Capital Programming and Project Selection: A Synthesis of Highway Practice*, 1997.

by working down the list.[7] Recognizing that transportation investments have little effect on overall economic performance and that benefit-cost analyses are designed to capture these benefits, economists view indirect economic impacts as transfers between different areas, rather than real gains for a region as a whole. Including these effects in calculations of social benefits will usually involve counting some benefits twice and therefore overstate the total benefits of the project.[8]

Those who oppose adding an economic development criterion to the decisionmaking process argue that such a consideration would, in effect, re-rank the list, raising the priority of some investments with fewer net benefits and lowering investments with more benefits. While some may support an economic development criterion with the goal of improving economic performance or regional equity, critics suggest that both the state as a whole *and* lagging areas would be better served if we simply made the best possible transportation investments. They suggest using more direct methods, such as improving education and training, to address economic development concerns. The same economic analyses that found public infrastructure investments have only a small effect on economic performance also found that the availability of a skilled labor force has a strong effect.[9] This finding suggests that, if policymakers want to foster economic development, a more effective strategy would be to target improvements in education and training.

## Example: Findings of the Northern Great Plains Rural Development Commission's Transportation Infrastructure Workgroup

In an attempt to identify the role that transportation infrastructure should play in promoting the economic development of rural areas of the northern Midwest, the Northern Great Plains Rural Development Commission convened a Transportation Infrastructure Work Group in 1995. The commission charged the work group with identifying how transportation policy could best serve the economic development needs of rural areas in their states.

Among its significant findings, the Transportation Infrastructure Work Group concluded that the key to advancing economic development was to make fundamentally sound investment decisions that reflected best practices in transportation planning. They found that:

- Each investment or disinvestment in rural transportation infrastructure should be based on a rigorous analysis of benefits and costs.
- All transportation investments should be evaluated on an intermodal basis, rather than within a single mode.
- "No public or private investment should be based on the concept of 'if we build it, they will come.'"[10]

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[7] United States Department of Transportation Federal Highway Administration, *Least-Cost Planning: Principles, Applications, and Issues*, July 1995.

[8] United States Department of Transportation Federal Highway Administration, *Least-Cost Planning: Principles, Applications, and Issues*, July 1995.

[9] Transportation Research Board, *Macroeconomic Analysis of the Linkages Between Transportation Investments and Economic Performance*, 1997.

[10] Northern Great Plains Initiative for Rural Development Transportation Infrastructure Work Group, *Final Report*.

# PERFORMANCE ON EVALUATIVE CRITERIA

## Solves the Most Critical Problem First

Evaluating the performance of an economic development criterion as a solution to the problem depends on the definition of the problem. If the goal is to generate economic benefits in specific areas of the state and thus improve economic equity among regions, then including an economic development criterion in the investment prioritization process will further that goal. If, on the other hand, the goal is to promote economic development in the state as a whole, evidence suggests that including an economic development criterion in the decisionmaking process will be ineffective.

According to best practices in transportation planning, agencies should conduct a rigorous assessment of the benefits and costs of every major project in a given area and fund only those projects that generate the greatest net benefits. While the methods of benefit-cost analysis have room for some improvement, the consensus among most transportation planners and economists is that setting investment priorities using the benefit-cost framework continues to be the most effective way to maximize investment dollars.

## Cost-Effectiveness

If the goal is to promote economic equity among regions, then including an economic development criterion in the project selection process could further that goal. However, favoring transportation investments in lagging areas to foster economic development is not necessarily the most cost-effective strategy for promoting equity.

## Produces Measurable Change

While adding an economic development criterion would generate *some* economic growth in lagging regions, it is unlikely to cause measurable changes in long-term economic growth.[11] This point is especially true from a statewide perspective on economic growth.

## Public Acceptability

Promoting economic equity among regions appears to enjoy broad support throughout the state. However, the current support could shift as people gain a better understanding of the tradeoffs associated with expanding the role of an economic development criterion in setting investment priorities.

## Administrative Feasibility

Depending on the structure of an economic development criterion, few administrative obstacles should prevent including such a criterion as part of the investment selection process.

[11] John B. Crihfield, Transportation and other Public Infrastructure in a Neoclassical Growth Model, Transportation Research Board, *Macroeconomic Analysis of the Linkages Between Transportation Investments and Economic Performance*, 1997.

### Maintains or Enhances Safety

On a local level, an economic development criterion that led to more investments in lagging areas would likely improve the overall safety in those regions. On the state level, it is difficult to determine how including such a criterion would influence safety.

## AREAS OF UNCERTAINTY AND DEBATE

As this brief memorandum indicates, disagreements exist about the potential benefits of including an economic development criterion in the process for selecting transportation investments. Some areas of particular controversy include the following issues:

- The extent to which transportation investments affect overall economic growth.
- The social value of transfers between populations with different incomes.
- The degree to which existing valuation techniques are capable of capturing economic gains associated with public investments.